

In June 2022, the EU published the final version of the 'DLT Pilot Regime'. Later this month, on March 23rd, the regime will formally be open to applications. The regulatory sandbox will act as a probing ground for a secondary market in financial instruments that are based on distributed ledger technology. Under certain conditions, the participating actors will be allowed to obtain an EU-wide temporary authorisation to offer DLT-based trading facilities and/or settlement systems to both professional and, in some cases, retail clients.

## EU LAUNCHES ITS DLT PILOT REGIME

### GENERAL OVERVIEW

#### BACKGROUND AND OBJECTIVE

As part of the digital finance package, the EU sports two main legislative initiatives to regulate recent developments in the crypto industry: (i) the upcoming Regulation on markets in crypto-assets ("MiCA") and (ii) Regulation 2022/858 of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology (the "DLT Pilot Regime").

While MiCA will set forth the legal framework regarding the issuance and trading of currently largely unregulated crypto-assets, the DLT Pilot Regime seeks to provide a regulatory sandbox for specific authorisations for the trading and settlement of financial instruments that are based on distributed ledger technology ("DLT"). Its primary goal is to assess the appetite of the markets for this new regime, which in essence forms a bridge between traditional financial markets and DLT.

#### SCOPE

The DLT Pilot Regime sets out the rules for granting specific EU-wide permissions to operate 'DLT market infrastructures', where three different types of market infrastructures can be distinguished:

- DLT multilateral trading facilities ("DLT MTF");
- DLT settlement systems ("DLT SS");
- DLT trading and settlement systems ("DLT TSS").

The concepts of MTF's and SS's are known from respectively EU Directive 2014/65 of 15 May 2014 on markets in financial instruments ("MiFID II") and the EU Regulation 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories ("CSDR"), whereby the model of the TSS is newly introduced as a combination of both systems.

Under the regime, DLT MTFs may only be operated by investment firms and market operators, as defined under MiFID II. DLT SS on the other hand can only be operated by central securities depositories, as defined under the CSDR. DLT TSS can be operated by both investment firms / market operators and central securities depositories ("CSDs").

In addition, new market entrants can also apply for a temporary authorisation as one of the aforementioned categories in combination with a DLT permission if their sole purpose is to operate one of the three types of DLT market infrastructures. In that case, they should tie this request for a DLT permission with an authorisation as an investment firm, market operator or CSD under respectively MiFID II or the CSDR. Such MiFID or CSDR authorisation can however be revoked by the competent authority if any exemptions under the DLT Pilot Regime are still in place when the DLT permission expires.

## I FINANCIAL INSTRUMENTS

In light of the sandbox nature of the DLT Pilot Regime, there are certain limitations to the types of financial instruments that can be traded and/or settled on DLT market infrastructures.

Generally, only the following instruments are admitted:

- a. Shares with a market capitalisation of less than 500 million EUR;
- b. Bonds, other forms or securitised debt or money market instruments with an issue size of less than 1 billion EUR;
- c. Units in collective investment undertakings, with a market assets value under management of less than 500 million EUR.

In addition to the above restrictions, several other limitations apply. In particular, maximum thresholds are set in place in relation to the aggregated market value of the financial instruments that are admitted to the DLT market infrastructures.

## I OBLIGATIONS AND EXEMPTIONS

Operators will in principle have to comply with the same rules as their equivalent non-DLT based market infrastructures. Operators of DLT TSS, which is a new category under the regime, will have to comply with a combination of rules on both DLT MTF and SS.

At the request of the operator, and under specific conditions, several exemptions – such as offering services to retail clients – may be requested in the application. In such case, the competent authority may however impose compensatory measures that are deemed appropriate. Within this context, the European Securities and Market Authority (“ESMA”) will publish guidelines on the compensatory measures that authorities may impose.

## I ADDITIONAL REQUIREMENTS

Asides from the main requirements imposed on DLT MTFs, DLT SS and DLT TSS, operators will in all cases need to provide:

- a. a clear and detailed business plan;
- b. rules on the functioning of the used DLT;
- c. clear and unambiguous website information on the execution of the operators’ activities;
- d. robust IT and cyber arrangements;
- e. adequate arrangements for the protection of client assets; and
- f. a clear and detailed exit strategy.



## | APPLICATION PROCESS

Applicants must submit their application file to their national authorities, which will assess whether it is complete within 30 working days after receipt of the application. The competent authorities are required to send a copy of the application file to the ESMA for review where in some cases, the ESMA may, after consulting the relevant competent authorities, issue a non-binding opinion on the application.

When the application file is deemed complete, the competent authorities will have 90 working days to carry out the full assessment of the application and decide whether the authorisation should be granted. A permission to operate will be valid throughout the EU for up to 6 years from the date of issuance and can – under certain conditions – be withdrawn at any stage during this time by the competent authorities.

## | ESMA REVIEW

By 24 March 2026, the ESMA will present a report to the EU Commission on the effect of the DLT Pilot Regime. Annual interim reports will be published on the functioning of the markets in light of the regime.

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**For any questions or assistance, please reach out to our**

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